

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

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Date:

June 25, 2002

LEGEND

Parent =

Merger Sub =

GP Sub =

Partnership =

Date 1 =

Date 2 =

Date 3 =

Year 1 =

Year 2 =

Month 1 =

Month 2 =

State X =

Business A =

n1 =

n2 =

\$n3 =

n4 =

n5 =

p1% =

p2% =

Dear :

This letter responds to your Date 1 request for certain rulings regarding certain federal income tax consequences of a proposed transaction. The information submitted in that request and later correspondence is summarized below.

SUMMARY OF FACTS

Parent was incorporated in Year 2 in State X as successor to an entity formed in Year 1. Parent is the common parent of an affiliated group of corporations that file a consolidated return for federal income tax purposes. Parent is engaged, directly and indirectly through its lower tier entities, in Business A.

Parent has one class of common stock ("Parent Common Stock"), of which approximately n1 shares are currently outstanding. Parent has approximately n2 shareholders, all of whom are required by the Parent restated certificate of incorporation to be employees or directors of Parent or its subsidiaries. There are no outstanding options or warrants to purchase Parent stock.

Parent sells shares of Parent Common Stock annually to employees at a formula price generally based on the total Parent stockholders' book equity as of the prior year-end, reduced by the net book value of the Parent's consolidated Business A equipment at such year end (the "Formula Price"). Parent Common Stock cannot be traded and, except for certain permitted assignments for estate planning purposes, may only be transferred back to Parent for cash at the Formula Price in effect as of the disposition date. When an employee retires, passes away, or otherwise terminates his employment with Parent or its subsidiaries, all shares of Parent Common Stock owned by him or his permitted transferee must be sold back to Parent at the Formula Price (and Parent is required to purchase all of employee's shares).

Parent has outstanding several series of ten-year convertible debentures in the aggregate principal amount of approximately \$n3. The convertible debentures are permitted to be held only by employees or directors of Parent or its subsidiaries. Holders of convertible debentures are entitled to convert the debentures into Parent Common Stock during the month of Month 1 in the n4 year after the debentures' respective issuance. The debentures bear a fixed, market rate of interest, payable annually. Prior to and in connection with the Restructuring (as defined below), Parent intends to accelerate the convertibility of all convertible debentures into Parent Common Stock. Any such debentures not converted will be redeemed by Parent at the face amount plus accrued interest, so that no debentures will be outstanding at the time of Restructuring (as defined below).

Parent and the other members of the Parent consolidated group are accrual method taxpayers and account for long-term Business A contracts on the percentage of completion method.

Parent's tax year and the tax year of most of the other members of the Parent consolidated group, is a 52-53 week year that ends on the last Saturday in Month 2. Those members of the Parent consolidated group that do not share this 52-53 week tax year have a Date 2 tax year end.

Parent will participate in the following series of transactions ("the Restructuring"):

- (1) Parent will, under applicable state law, convert or merge all or most of its existing corporate subsidiaries into partnerships or disregarded entities for federal income tax purposes.
- (2) Parent will form a wholly owned subsidiary (Merger Sub) and transfer all of Parent's assets, subject to assumption of all of Parent's liabilities, to Merger Sub in exchange for p1% of Merger Sub's stock.
- (3) Merger Sub will then create a wholly-owned subsidiary (GP Sub) and transfer a less than p2% interest in each of its assets and liabilities to GP Sub in exchange for p1% of GP Sub's stock.
- (4) Merger Sub and GP Sub will form a limited partnership (Partnership).
 - (A) Merger Sub will contribute the remainder of the undivided interests in its assets and liabilities (other than its stock in GP Sub) to Partnership in exchange for equity interests in Partnership (the Partnership interests) and the assumption of the remaining liabilities of Merger Sub.
 - (B) GP Sub will transfer its assets, subject to its liabilities, to Partnership in exchange for a less-than-p2% general partner interest in Partnership.
- (5) Merger Sub will merge into Parent, with Parent surviving. In connection with

such merger, Parent will distribute 40-65% of both its Partnership interests and its GP Sub shares to a subset of shareholders ("Exchanging Shareholders") in complete redemption of all their Parent common stock (which will approximate the same above stated percentage of the outstanding Parent common stock) ("the Distribution"). Following these redemptions, Parent will have no more than 5 continuing shareholders and will retain 35-60% of the Partnership interests and 35-60% of the GP Sub shares.

- (6) Parent will elect S corporation status to be effective with its 52-53 week tax year beginning Date 3.
- (7) Partnership and its lower tier entities will continue to carry on the Business A business formerly conducted by Parent and its lower tier entities prior to the Restructuring. Partners in Partnership will include: (a) GP Sub (the general partner), (b) the former Parent shareholders (limited partners); and (c) Parent (as an S Corporation) (limited partner).

It is anticipated that Parent will not issue any new shares of Parent Common Stock after the Restructuring. Instead, it is presently contemplated that following the Restructuring, any employees or directors admitted as equity holders in Business A will be admitted as partners in Partnership subject to formula price buy/sell provisions and permanent transfer restrictions similar to those applicable to Parent Common Stock prior to the Restructuring.

REPRESENTATIONS

Parent has made the following representations with respect to the Restructuring:

- (a) The principal purpose of Parent's contribution of all the Business A assets to Partnership (through Merger Sub and GP Sub) is not the recognition of any loss, directly or indirectly, on any such assets in connection with the Distribution. Rather, the principal purpose of the Parent's contribution of all the Business A assets to Partnership (through Merger Sub and GP Sub) and the Restructuring as a whole is to restructure Parent so that the Business A business that was carried on by Parent and its lower tier entities prior to the Restructuring will be conducted in partnership form by Partnership and its lower tier entities on a continuing basis following the Restructuring.
- (b) Following the Restructuring, it is intended that Partnership and its lower tier entities will continue to carry on the Business A business that was carried on by Parent and its lower tier entities prior to the Restructuring.
- (c) Parent will transfer (through Merger Sub and GP Sub) all of its assets (other than

the stock in GP Sub) to Partnership subject to all of its liabilities.

- (d) Parent will report all earned income represented by assets and liabilities that will be contributed to Partnership such as receivables being reported on a cash basis and commissions due. The assets and liabilities to be contributed to Partnership will also include unfinished long-term contracts, the income from which Parent and Partnership will report in accordance with Parent's historic method of accounting under § 460.
- (e) At the time of the Restructuring, there will be no amounts payable or receivable between Partnership and GP Sub, on the one hand, and Parent on the other hand, other than such obligations as may arise under indemnity arrangements to be entered into between the parties.
- (f) There is no intention following the Restructuring to dispose of any material assets of the Business A business contributed to Partnership (other than transfers to lower tier entities or transfers in the ordinary course of business).
- (g) Partnership interests and GP Sub interests will be subject to formula price buy/sell provisions and permanent transfer restrictions similar to those applicable to Parent Common Stock prior to the Restructuring.
- (h) Other than convertible debentures, there are no outstanding options or warrants to purchase Parent Common Stock and there are no other outstanding instruments that are convertible into Parent Common Stock.
- (i) No notes or other obligations of Parent will be distributed to a redeemed Parent shareholder in the Restructuring.
- (j) Merger Sub will be formed solely for purposes of facilitating the Restructuring.
- (k) For purposes of measuring the Section 311(b) gain to Parent on distribution of Partnership interests, the distributed Partnership interests will be valued at a percentage of the value of the entire Business A business held by Partnership. Such percentage shall be equal to the percentage of Parent stock that is redeemed from the Exchanging Shareholders in the Restructuring. Cf. Pope & Talbot, Inc. v. Commissioner, 104 T.C. 574 (1995), affirmed 162 F.3d 1236 (9th Cir. 1999).
- (l) The management of Parent is not aware of any plan or intention on the part of any partner in Partnership following the Restructuring to dispose of any Partnership interests, except in the ordinary course of business or in connection with termination of employment.

RULINGS

Based solely on the information submitted and on the representations set forth above, we rule as follows:

- (1) Merger Sub will be disregarded for federal income tax purposes as a transitory entity. Parent will be treated as (i) directly transferring a less than p2% undivided interest in its assets, subject to a proportionate amount of its liabilities, to GP Sub in exchange for p1% of the stock of GP Sub (GP Sub will be treated as if it then transferred those assets and liabilities to Partnership for a less than p2% general partner interest in Partnership); (ii) directly transferring the remainder of the undivided interest in its assets (other than the GP Sub shares), subject to its remaining liabilities, to Partnership in exchange for the Partnership interests, and (iii) distributing a portion of the Partnership interests and GP Sub shares to the Exchanging Shareholders in exchange for their Parent Common Stock.
- (2) Parent will not recognize income, gain or loss on the contribution of all the assets it will transfer to Partnership in exchange for equity interests in Partnership and the assumption of liabilities of the transferred Parent business. (§721, §752).
- (3) The adjusted basis of the assets of Parent received by Partnership will be the same as the adjusted basis of such assets in the hands of Parent. (§ 723).
- (4) Parent will recognize income or gain, if any, but not loss, on the distribution of Partnership interests and GP Sub shares in redemption of the Exchanging Shareholder's Parent Common Stock based upon the difference between the fair market value of the Partnership interests and GP Sub shares distributed on redemption and their adjusted tax basis in the hands of Parent. (§ 311(b)).

CAVEAT

No opinion is expressed about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings.

PROCEDURAL STATEMENTS

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of

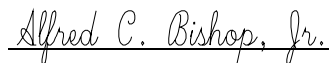
the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to the federal income tax return of each taxpayer involved in the taxable year in which the transaction is consummated.

Pursuant to a power of attorney on file in this office, we have sent the original of this letter to the taxpayer's representative and a copy of this letter to the taxpayer.

Sincerely yours,



Alfred C. Bishop, Jr.
Branch Chief, Branch 6
Office of Associate Chief Counsel
(Corporate)

cc: